Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy



# Oil India Ltd

## Play on rising oil & gas prices; upgrade to Buy

| Oil & Gas | Sharekhan code: OIL | Company Update |
|---|---|---|

| 3R MATRIX | + | = | - |
|---|---|---|---|
| Right Sector (RS) | ✓ | | |
| Right Quality (RQ) | ✓ | | |
| Right Valuation (RV) | ✓ | | |

\+ Positive = Neutral - Negative

**What has changed in 3R MATRIX**

| | Old | | New |
|---|---|---|---|
| RS | Neutral | ↑ | Positive |
| RQ | Positive | ↔ | Positive |
| RV | Positive | ↔ | Positive |

| Reco/View | Change |
|---|---|
| Reco: **Buy** | ↑ |
| CMP: **Rs. 206** | |
| Price Target: **Rs. 250** | ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade

**Company details**

| | |
|---|---|
| Market cap: | Rs. 22,328 cr |
| 52-week high/low: | Rs. 209/83 |
| NSE volume: (No of shares) | 14.0 lakh |
| BSE code: | 533106 |
| NSE code: | OIL |
| Free float: (No of shares) | 47.00 cr |

**Shareholding (%)**

| | |
|---|---|
| Promoters | 56.7 |
| FII | 8.5 |
| DII | 18.5 |
| Public & others | 16.3 |

**Price chart**


**Price performance**

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 26 | 40 | 56 | 119 |
| Relative to Sensex | 21 | 28 | 39 | 70 |

*Sharekhan Research, Bloomberg*

**Summary**

- Oil India Limited's (OIL) business fundamentals have turned positive with Brent oil prices at ~$74/bbl and a sharp rise in international gas prices. We expect standalone PAT to clock a CAGR of 34% and RoE to improve to 11.3% over FY21-24E.
- Increase in Numaligarh Refinery Ltd (NRL) stake is earnings accretive as GRMs would remain strong given excise duty benefit and 3x expansion in refinery capacity to create long-term value for OIL.
- The management expects combined oil & gas production to grow by 6-7% annually in the long term, but we believe majority of production growth to be back-ended and model an oil/gas production CAGR of 2%/4% over FY21-24E.
- Robust earnings recovery and dividend yield of ~6% makes risk-reward favourable. Hence, we upgrade OIL to Buy from Hold with a revised SoTP-based PT of Rs. 250. OIL is trading at 3.7x its FY23E EPS (including earnings contribution from NRL).

**We see a risk-reward scenario turning favourable for Oil India Limited (OIL) given: 1) earnings outlook for core oil & gas E&P business has improved considerably with sharp recovery in oil & gas price and 2) recent increase in stake in NRL is earnings accretive (benefit of excise duty) and expected to create long-term value for OIL. Recovery in RoE to 11.3% by FY24E and dividend yield of ~6% provides comfort. Potential domestic gas pricing reforms could act as key re-rating catalyst. Upgrade OIL to Buy (from Hold).**

- **High crude oil price and likely domestic gas price hike to drive a 34% PAT CAGR over FY21-24E:** OIL is a direct beneficiary of recent sharp recovery in Brent crude oil price to ~$74/bbl (led by higher oil demand and calibrated oil production increases by OPEC Plus member countries). Furthermore, domestic gas prices are expected to be revised upward by ~70% to $3/mmBtu from October 2021 and elevated international gas prices (US Henry Hub natural gas prices are now at >$5/mmBtu) would mean further hike in domestic gas price from April 2022. We thus expect OIL's PAT to clock a robust 34% CAGR over FY2021-FY2024E and reach pre-pandemic level of Rs. 3,341 crore by FY2024E.
- **NRL stake increase to create long-term value:** BPCL has divested its stake in NRL (as part of its divestment process) and consequently OIL has hiked its stake in NRL to 69.63% (from 26% earlier). OIL is a clear beneficiary here given NRL's high earnings track record (FY2021 PAT of Rs. 3,116 crore and RoE of ~56%) supported by excise duty benefit (retains 50% of excise duty on petrol and diesel). NRL capacity expansion plan to 9 mtpa (from 3 mtpa currently) by FY2025E would create long-term value and the acquisition is earnings accretive for OIL.
- **Ambitious plan to augment oil & gas production but we model 2-4% CAGR over FY21-24E:** OIL, in its recent presentation, has guided to increase combined oil & gas by 6-7% annually in long term. The company's management in quite optimistic on ramp-up of gas production from the Baghjan field to 5 mmscmd by FY2024E from 1.5mmscmd currently. We believe that majority of production ramp-up would be back ended (i.e. by FY24E-25E) and model oil/gas production CAGR of 2%/4% over FY21-24E given ageing oil fields.

**Our Call**

**Valuation – Upgrade OIL to Buy with revised SoTP based PT of Rs. 250:** The recent sharp rally in oil prices and expectation of steep hike in domestic gas prices would drive a 34% CAGR in OIL's standalone PAT over FY21-24E and improve RoE to 11.3% (versus only 5.4% in FY2021). Moreover, the recent stake increase in NRL could create long-term value for OIL. Hence, we upgrade OIL to Buy (from Hold) with a revised SoTP based PT of Rs. 250 (increase reflects upward revision in standalone earnings and higher value for NRL). The stock is trading at 3.7x FY23E EPS (including earnings contribution from NRL).

**Key Risks**

A sharp decline in international oil & gas prices and lower-than-expected production (in case of delayed ramp-up from new fields) could impact earnings outlook and valuation. Any unwarranted capex for overseas/domestic acquisition could raise capital allocation concerns.

**Valuation (Standalone)** Rs cr

| Particulars | FY21 | FY22E | FY23E | FY24E |
|---|---|---|---|---|
| Revenue | 8,618 | 12,810 | 14,291 | 14,798 |
| OPM (%) | 14.7% | 32.1% | 32.8% | 32.5% |
| Adjusted PAT | 1,377 | 2,611 | 3,080 | 3,341 |
| y-o-y growth (%) | -57.1% | 89.6% | 18.0% | 8.5% |
| Adjusted EPS (Rs.) | 12.7 | 24.1 | 28.4 | 30.8 |
| PE (x) | 16.2 | 8.6 | 7.2 | 6.7 |
| P/BV (x) | 0.9 | 0.8 | 0.8 | 0.7 |
| EV/EBDITA (x) | 28.9 | 8.9 | 7.6 | 7.2 |
| ROE (%) | 5.4% | 9.7% | 11.0% | 11.3% |
| ROCE (%) | 4.3% | 9.5% | 10.6% | 11.0% |

*Source: Company; Sharekhan estimates*

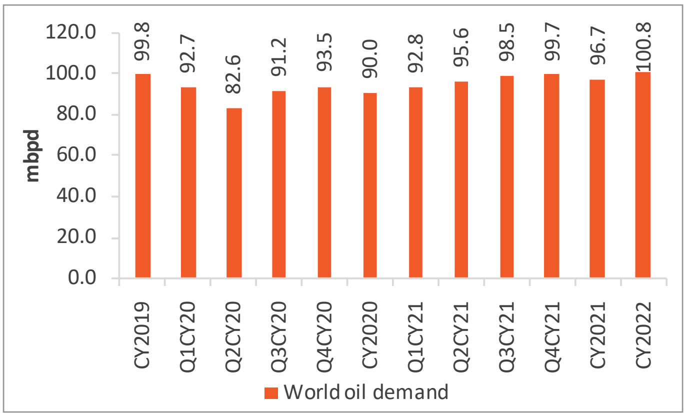
### Improving oil & gas realisation to aid strong recovery in earnings

We expect OIL's net crude oil and gas realisation to rise sharply to $65-70/bbl and $2.6-3.8/mmBtu respectively over FY2022E-2024E led by the recent sharp recovery in international oil & gas prices. OIL's oil/gas production to grow at 2%/4% CAGR over FY2021-FY2024E to 3.1 mmt/2.9 bcm. Thus, we expect a robust CAGR of 56% over FY2021-FY2024E in OIL's standalone EBITDA to Rs. 4,807 crore by FY2024E.

### Recovery in world oil demand lifts Brent oil price to ~$74/bbl

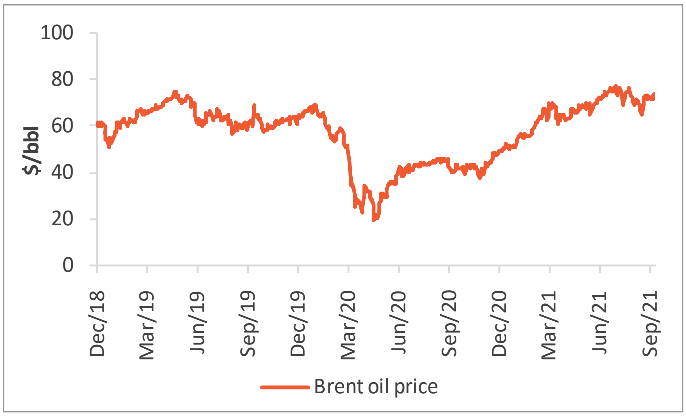
Oil demand has bounced back strongly led by sharp pick-up in global economic activity and rising mobility and travelling given sharp ramp-up in COVID-19 vaccination globally. Thus, OPEC expects global oil demand to increase by 6 mbpd and 4.2 mbpd in CY2021/CY2022 to 96.7 mbpd/100.8 mbpd. In fact, OPEC has revised its CY2022 oil demand growth forecast by 0.9 mbpd in its recent monthly oil market report and expect oil demand to reach above pre-COVID-19 level in CY2022.

**World oil demand to reach pre-pandemic level in CY22**




*Source: OPEC; Sharekhan Research*

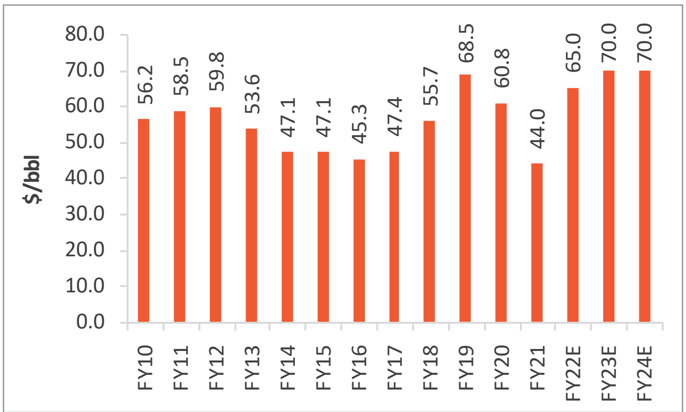
**Brent oil price recovers to ~$74/bbl level**




*Source: Bloomberg; Sharekhan Research*

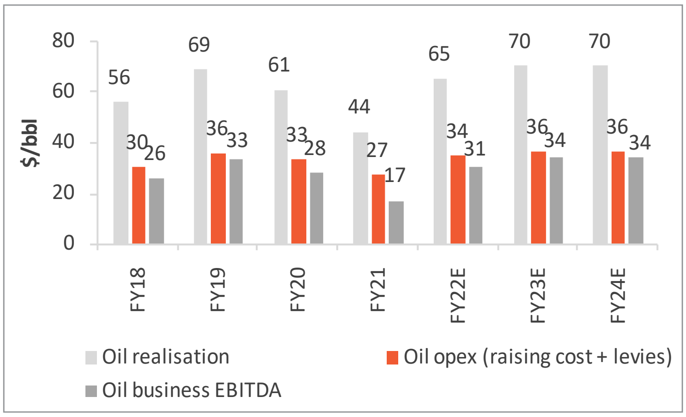
Improved oil demand and calibrated production hikes by OPEC has led to sharp rally in Brent crude oil prices to the current level of ~$74/bbl and average of $70.6/bbl in FY22YTD, an increase of 54% compared to average Brent crude oil price of $45.7/bbl. Sustained high oil price would mean best ever oil price realisation for Oil India at $65/$70/$70 per barrel in FY22E/FY23E/24E as compared to average net oil realisation of $53.4/bbl (impacted by oil subsidy) over FY11-FY21.

**OIL's net oil realisation to recover to FY19 level**




*Source: Company; Sharekhan Research*

**High oil price to improve profitability of oil business**

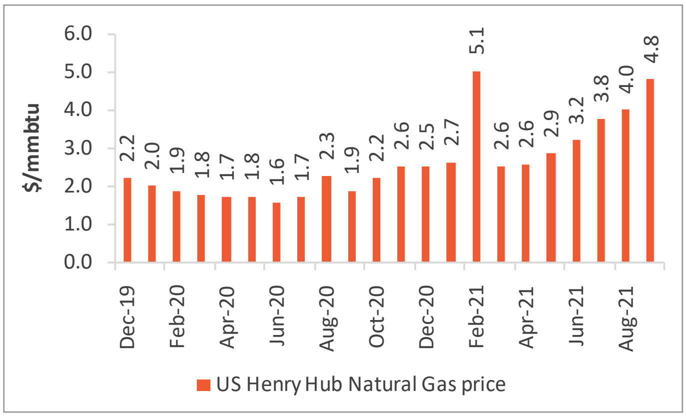



*Source: Company; Sharekhan Research*

### Sharp recovery in international gas price to drive meaningful upward revision in APM gas price

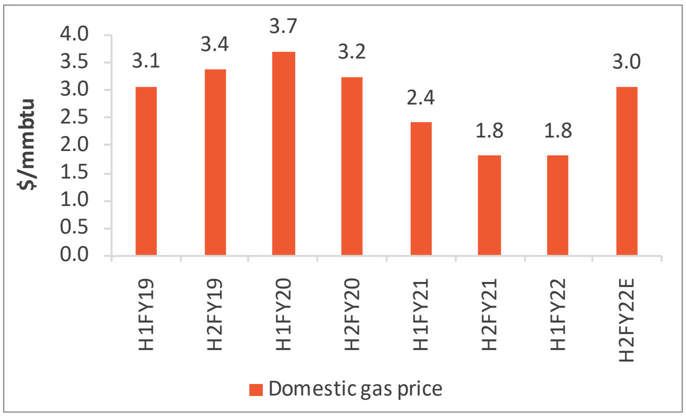
Domestic gas prices bottomed at $1.79/mmBtu (corrected by 65% since 2015) and is expected to increase by 60-70% for H2FY2022 as international gas price has recovered sharply with a revival in global economy and focus on higher use of gas to curb pollution. With the US Henry hub gas prices at $5.3/mmBtu and other benchmark gas prices (for Europe, Russia and Canada) also increasing, we expect upward revision in domestic gas price to continue for H1FY2023. We thus expect Oil India's gas realisation to improve to $2.6/$3.4/$3.8 per mmBtu in FY22E/FY23E/FY24E as compared to $2.3/bbl in FY2021.

**US Henry hub gas price increases to $5.3/mmBtu in Sept 2021**



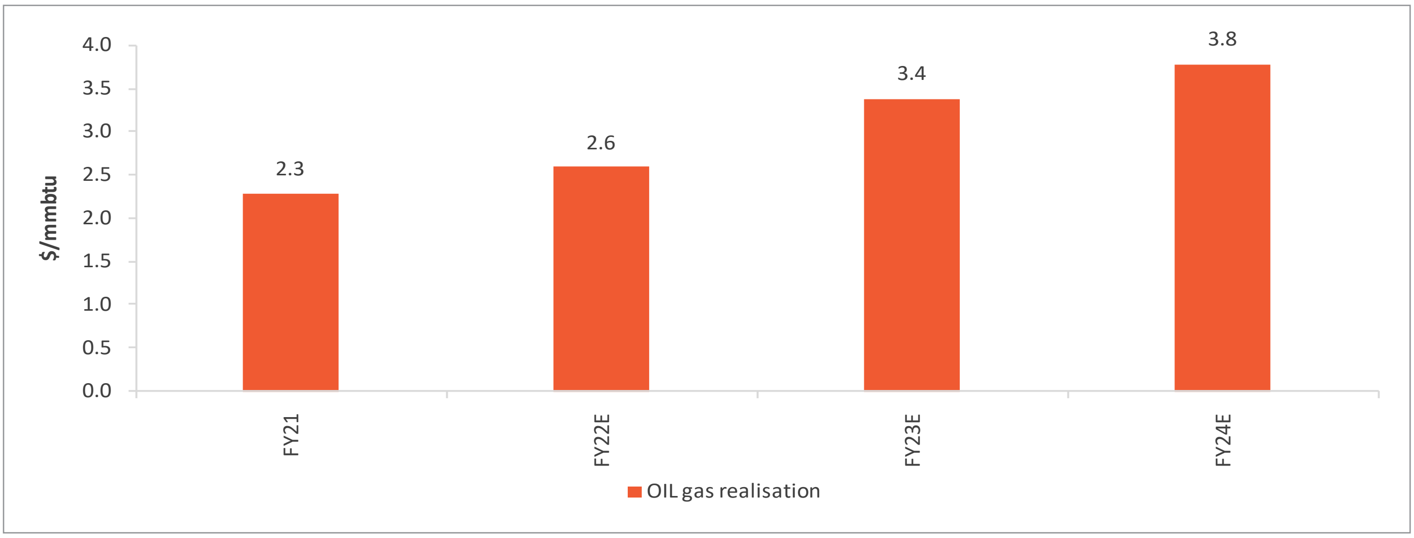

*Source: Bloomberg; Sharekhan Research*

**Domestic gas price to recover from H2FY22**




*Source: PPAC India; Sharekhan Research*

**OIL gas realisation to improve considerable over FY22E-24E**



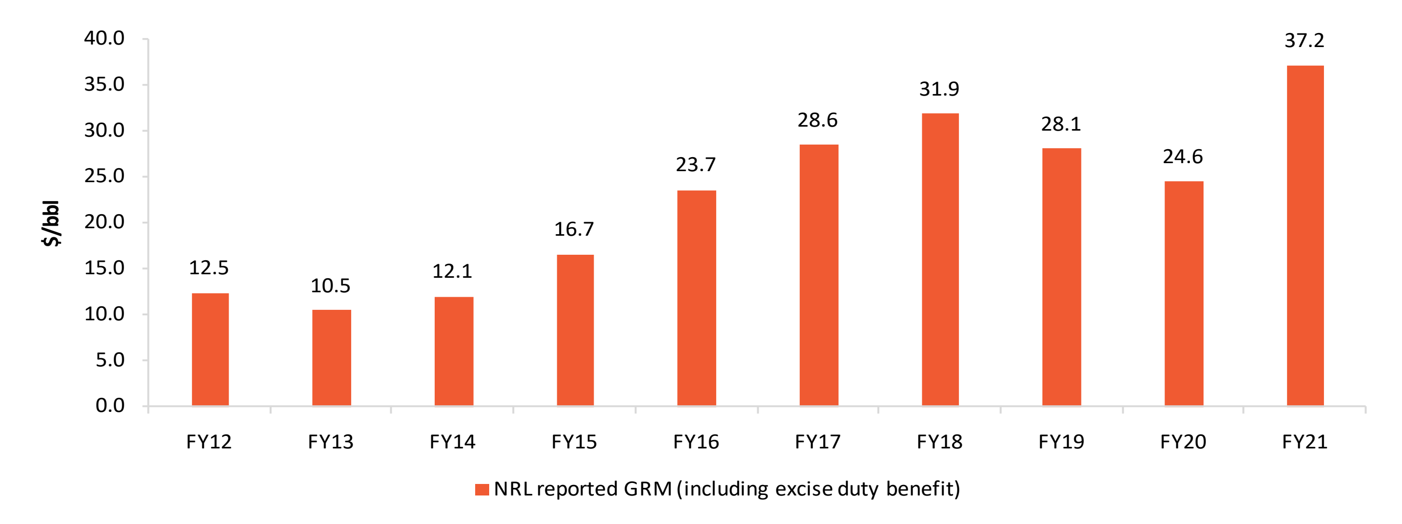

*Source: Company; Sharekhan Research*

### NRL stake hike – A significant positive that would create long term value for OIL

BPCL has divested its 61.5% stake in NRL as part of BPCL's ongoing divestment process. Accordingly, OIL has acquired 43.63% stake in NRL from BPCL for total cash consideration of ~Rs. 6,988.82 crore along with the transfer of NRL's management control to OIL. With this, OIL's stake in NRL has increased to 69.63% and the remainder is with Government of Assam (stake of 26%) and Engineers India Limited (stake of 4.37%).

NRL has a crude oil refining capacity of 3 mtpa with a product slate having higher share of diesel (accounts for 66% of refinery production) and petrol (accounts for 23% of refinery production). NRL's reported GRM has remained high at $37.2/bbl (core GRM of $4.1/bbl and excise duty benefit of $33.1/bbl) in FY2021 as it retains 50% of excise duty on petrol and diesel as part of the Assam Accord.

NRL GRM remains strong supported by excise duty benefit




*Source: NRL; Sharekhan Research*

## NRL capacity expansion to 9 mtpa by FY25E – could result in 3x/2x rise in EBITDA/PAT by FY25E

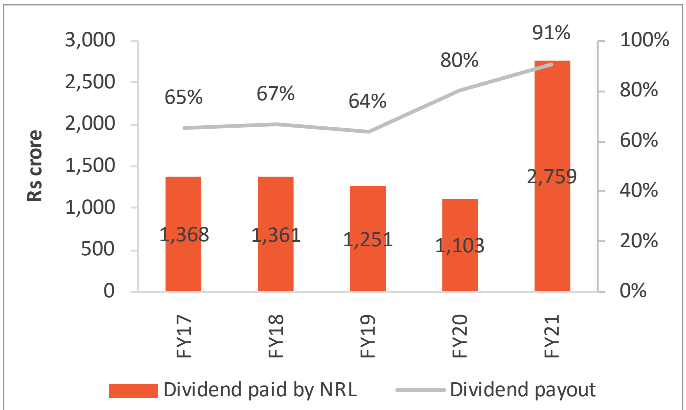
NRL plans to increase its refining capacity to 9 mtpa (from 3 mtpa currently) along with a petrochemical complex with an estimated capex of Rs. 28,000 crore and the expansion is scheduled to be completed by FY2024E-FY2025E. The Capex would be funded by 70% debt and the balance 30% would be through equity. NRL's internal resources would be enough to fund the 30% equity of Rs. 6,000 crore. Given the excise duty benefit (although expect the same to get reduced going forward), we estimate NRL's EBITDA/PAT to increase by 3x/2x to Rs. 10,990 crore/Rs. 6,096 crore by FY2025E as compared to Rs. 4,347 crore/Rs. 3,116 crore in FY2021. Sustained high profitability and expansion at NRL would create long-term value for OIL and also result in consistent high dividend income from NRL.

NRL profitability to remain strong over FY22-FY25E

| Particulars | FY21 | FY22E | FY23E | FY24E | FY25E |
|---|---|---|---|---|---|
| Capacity (mmt) | 3.0 | 3.0 | 3.0 | 3.0 | 9.0 |
| Utilisation | 90% | 95% | 95% | 95% | 80% |
| Throughput (mmt) | 2.7 | 2.9 | 2.9 | 2.9 | 7.2 |
| Reported GRM ($/bbl) | 37.2 | 33.1 | 34.1 | 34.1 | 34.1 |
| Excise duty benefit ($/bbl) | 33.1 | 28.1 | 28.1 | 28.1 | 28.1 |
| Core GRM ($/bbl) | 4.1 | 5.0 | 6.0 | 6.0 | 6.0 |
| EBITDA (Rs crore) | 4,347 | 4,196 | 4,350 | 4,350 | 10,990 |
| PAT (Rs crore) | 3,116 | 2,983 | 3,069 | 3,047 | 6,096 |
| Rs/USD rate | 74 | 74 | 74 | 74 | 74 |

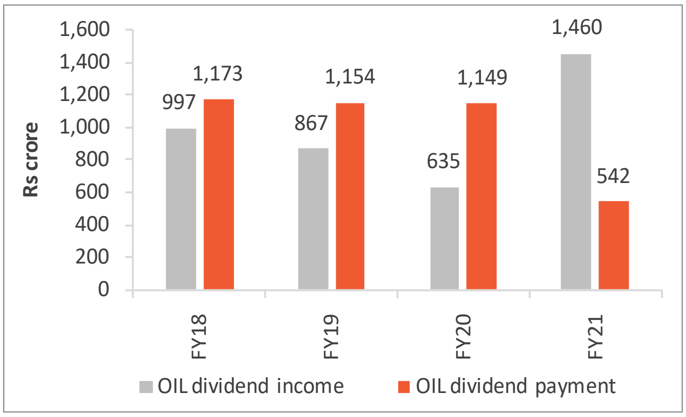
*Source: NRL; Sharekhan Research*

High dividend payout by NRL




*Source: OIL; NRL; Sharekhan Research*

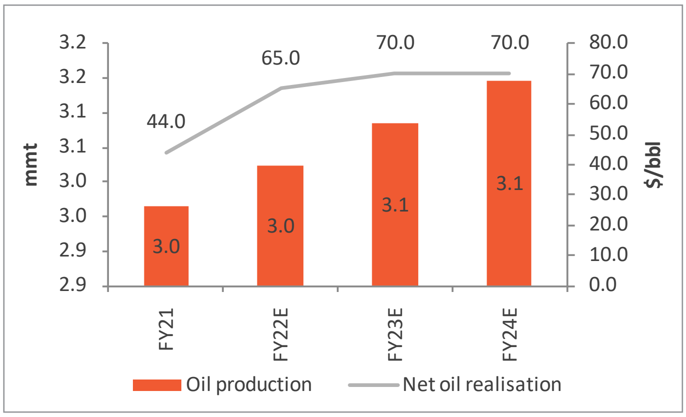
OIL dividend income and payment trend




*Source: OIL; NRL; Sharekhan Research*

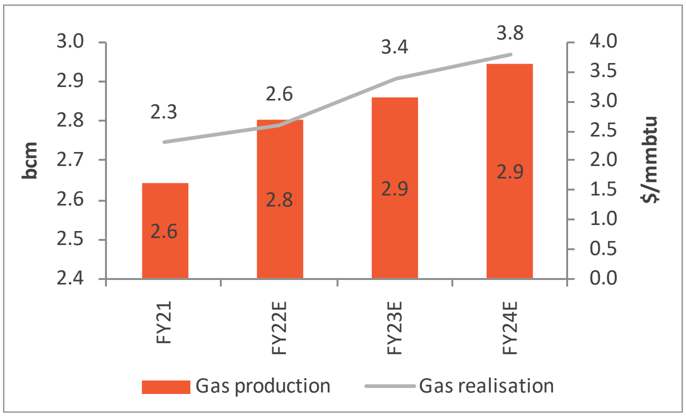
## Financials in charts

### Sharp recovery in oil realisation



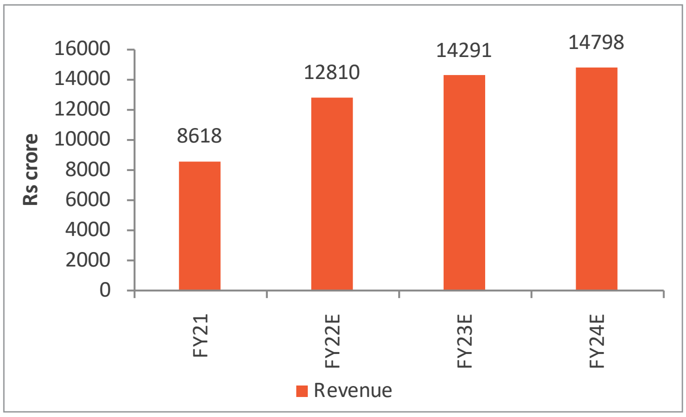

*Source: Company, Sharekhan Research*

### Gas realisation to improve over FY22E-24E



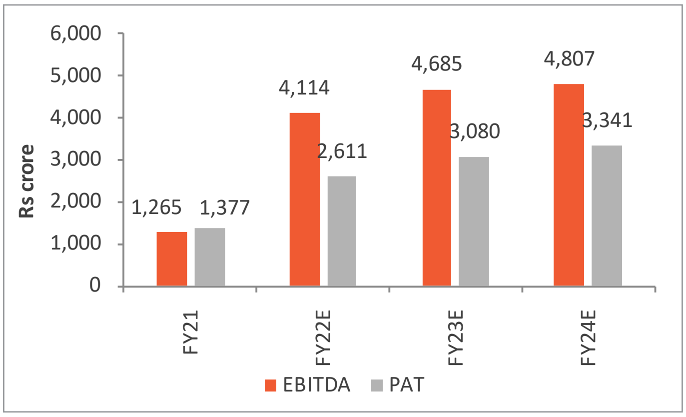

*Source: Company, Sharekhan Research*

### Revenue to recover sharply led by higher realisation



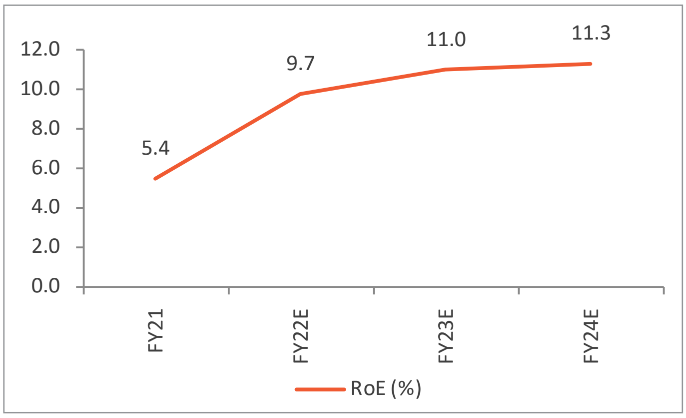

*Source: Company, Sharekhan Research*

### EBITDA/PAT to clock 56%/34% CAGR over FY21-24E



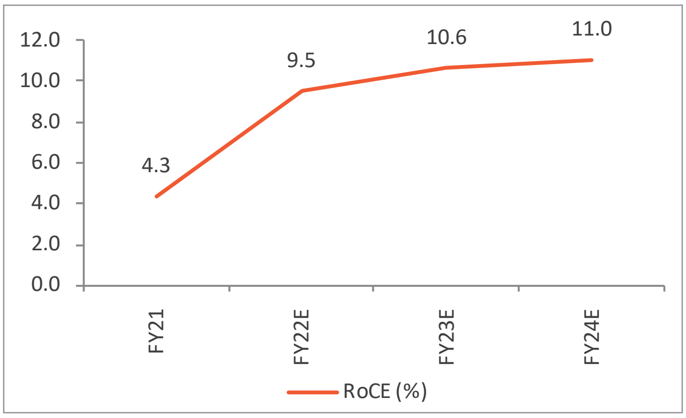

*Source: Company, Sharekhan Research*

### RoE to improve with earnings recovery




*Source: Company, Sharekhan Research*

### ROCE to witness sharp expansion




*Source: Company, Sharekhan Research*

## Outlook and Valuation

### ■ Sector view - Improving oil & gas price to drive strong earnings recovery for upstream oil companies

Earnings outlook for upstream PSUs' has improved considerably given a recent rise in crude oil prices ~$74/bbl mark and expectation of a steep hike in domestic gas price by 60-70% for H2FY2022 on current gas price of $1.79/mmBtu. With international gas prices (for US, Europe, Russia and Canada) sharply rallying in recent months, we believe that domestic gas prices would rise further in H1FY2023 and drive improvement in overall profitability of ONGC and Oil India. However, oil and gas production are expected to recover gradually with majority of the growth being back-ended (i.e. by FY2024E-FY2025E).

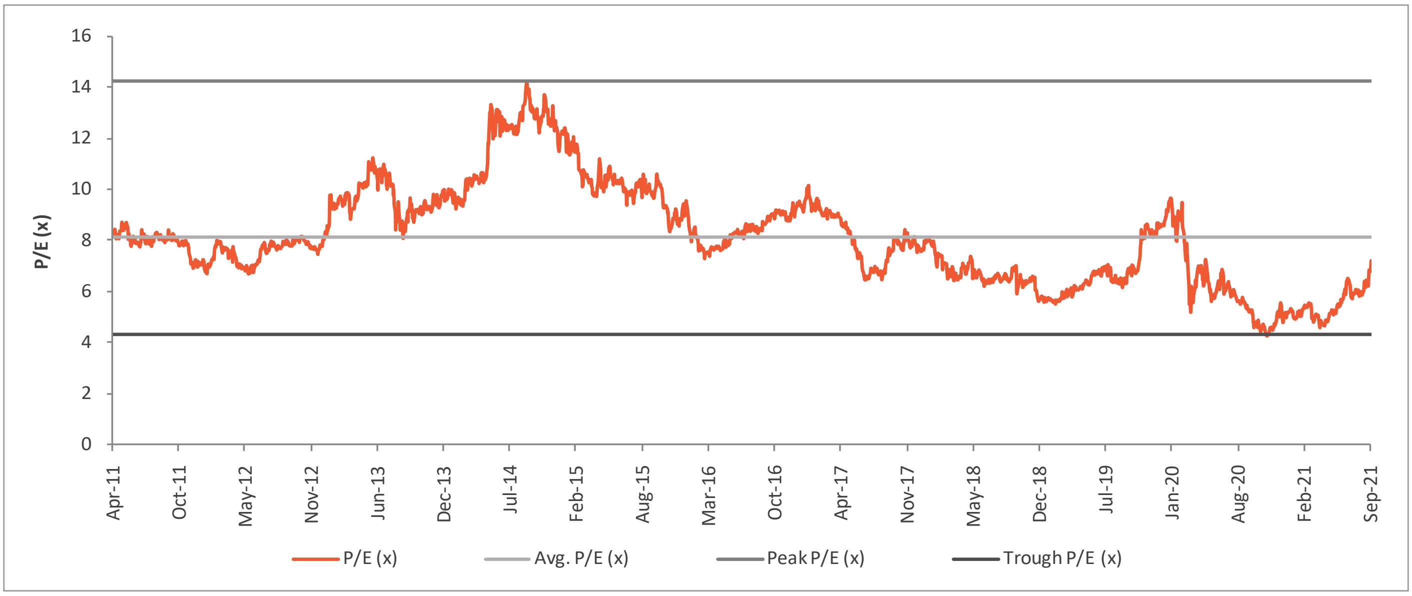
### ■ Company outlook - Recovery in oil price improves earnings outlook

OIL's earnings outlook is improving given the recent sharp recovery oil price and potential upward revision in domestic gas prices by 60-70% for H2FY2022. Thus, we expect OIL's standalone EBITDA/PAT to clock a CAGR of 56%/34% over FY2021-FY2024E and reach Rs4,807 crore/Rs3,341 crore by FY2024E along marked improvement in RoE to 11.3% by FY2024E versus only 5.4% in FY2021.

### ■ Valuation - Upgrade OIL to Buy with a revised PT of Rs. 250

The recent sharp rally in oil prices and expectation of steep hike in domestic gas prices would drive a 34% CAGR in OIL's standalone PAT over FY21-24E and improve RoE to 11.3% (versus only 5.4% in FY2021). Moreover, the recent stake increase in NRL could create long-term value for OIL. Hence, we upgrade OIL to Buy (from Hold) with a revised SoTP based PT of Rs. 250 (increase reflects upward revision in standalone earnings and higher value for NRL). The stock is trading at 3.7x FY23E EPS (including earnings contribution from NRL).

**One-year forward P/E (x) band**




*Source: Sharekhan Research*

## About company

Oil India is an Indian national oil company that explores, develops, and produces crude oil and natural gas, transports crude oil, and produces LPG. The company is the second-largest E&P company in India in terms of production and reserves. More than 95% of Oil India's production comes from its upper Assam basin. The company holds domestic 2P (proved and probable) reserves of 191mtoe (oil + gas) as of March 31, 2021.

## Investment theme

Earnings outlook for Oil India has improved considerably given recent sharp rally in oil price and expectation of steep hike in domestic gas price over next one year as benchmark international gas price has increased sharply. Higher oil & gas realisation would help earnings recover to pre-pandemic level and improve return ratios. Moreover, NRL acquisition is earnings accretive and create long term value for OIL. Stock is trading at attractive valuation and offers decent dividend yield.

## Key Risks

A sharp decline in international oil & gas price and lower-than-expected production (In case of delayed ramp-up from new fields) could impact earnings outlook and valuation.

Any unwarranted capex for overseas/domestic acquisition could raise capital allocation concerns.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Sushil Chandra Mishra | Chairman & Managing Director |
| Harish Madhav | Director – Finance |
| Pankaj Kumar Goswami | Director - Operations |

*Source: Company*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Life Insurance Corp of India | 11.9 |
| 2 | Indian Oil Corp Ltd | 4.9 |
| 3 | ICICI Prudential Asset Management Co. Ltd | 2.5 |
| 4 | Bharat Petroleum Corp Ltd. | 2.5 |
| 5 | Hindustan Petroleum Corp Ltd. | 2.5 |
| 6 | Nippon Life India Asset Management Ltd. | 2.1 |
| 7 | FMR LLC | 2.1 |
| 8 | WisdomTree Investments Inc. | 0.9 |
| 9 | Vanguard Group Inc/The | 0.9 |
| 10 | BlackRock Inc. | 0.8 |

*Source: Bloomberg*

## Understanding the Sharekhan 3R Matrix

| | |
|---|---|
| **Right Sector** | |
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| **Right Quality** | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet |
| **Right Valuation** | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

*Source: Sharekhan Research*

Sharekhan

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For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

**Registered Office:** Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;